



20 July 2022

TO: ALL RSE LICENSEES

RESPONSE TO SUBMISSIONS – STRENGTHENING INVESTMENT GOVERNANCE

On 29 September 2021, APRA released for consultation proposed revisions to *Prudential Standard SPS 530 Investment Governance* (SPS 530). APRA proposed key enhancements to valuation, stress testing and liquidity management requirements.

APRA is now releasing final SPS 530, which will commence 1 January 2023. This letter outlines the substantive matters raised in submissions, together with APRA's response.

These enhancements are an important step in ensuring RSE licensees meet their obligations prudently to select, manage and monitor investments, which is central to delivery of sound member outcomes.

APRA received twelve submissions in response to the proposed changes and met with a number of stakeholders during the consultation period. Respondents were broadly supportive of the proposed revisions to SPS 530. The main issues raised in submissions are outlined in Attachment A.

This letter also indicates the expected key areas of focus in the planned guidance, responding to requests by industry for enhancements to existing guidance. APRA plans to release draft *Prudential Practice Guide SPG 530 Investment Governance* (SPG 530) and draft *Prudential Practice Guide SPG 531 Valuations* (SPG 531) for consultation later in 2022, to assist in the implementation and application of the revised standard.

Key changes to SPS 530

APRA has made a small number of minor amendments to SPS 530 to respond to submissions. The amendments, which are discussed below and indicated in the accompanying tracked changes version of SPS 530, are:

- Consistent use of terminology to 'develop, implement and maintain' frameworks, policies and processes, where relevant. The addition of 'maintain' emphasises that APRA requires RSE licensees to ensure their frameworks, policies and processes are reviewed and remain fit for purpose over time.
- Clarification that stress-testing programmes and valuation governance are to be regarded as components of the overall investment governance framework.
- Clarification that regular reporting to the Board for each investment option and MySuper product does not have to include detailed reporting on individual investments. Instead, the Board must approve appropriate measures to monitor performance, including the benchmarking methodology, and ensure that investments that are failing to meet benchmarks, adversely affecting the performance of an investment option, are reported to the Board.
- Clarification that the valuation governance framework requirements do not require the establishment of a stand-alone Board valuation sub-committee.

Requests for enhanced guidance

In consulting on SPS 530, APRA indicated that it would consult on enhancements to supporting guidance after the completion of consultation on draft amendments to the standard. APRA intends to release draft guidance for consultation in Q4 2022, ahead of the commencement of SPS 530 on 1 January 2023.¹

The majority of submissions to the SPS 530 consultation requested detailed guidance to better reflect current investment practices and issues, and to support the implementation of the updated SPS 530. Some submissions sought more guidance, while others requested less prescription. Several submissions also sought further APRA guidance on the management of Environmental, Social and Governance (ESG) risks.

The draft prudential practice guides will aim to incorporate feedback from industry stakeholders, as well as a more streamlined approach to simplify guidance where possible, in line with APRA's approach to *modernising the prudential architecture* and the maturity of industry practices.²

If you have any queries in relation to this letter, please contact your APRA supervisor.

Yours sincerely,

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Executive Director
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¹ APRA has committed to limiting releases to RSE licensees during August and September 2022 to support an appropriate focus on the performance test.

² For further details on Modernising the prudential architecture, see Chapter 1 of [Information Paper: APRA's Policy Priorities](#).

ATTACHMENT A. RESPONSE TO SUBMISSIONS

This attachment summarises the main issues raised in submissions, along with APRA's responses.

1. Investment risks - ESG financial risks

Submissions called for more guidance on the consideration of ESG risks, including specific reference to ESG risk as a material investment risk to be considered at both the idiosyncratic and market-wide level. Some participants called for greater clarity on the interplay between *Prudential Practice Guide CPG 229 Climate Change Financial Risks* (CPG 229) and SPG 530. Submissions noted that the current SPG 530, released in 2013, limited the consideration of ESG factors to the offering of ethical style investment options as part of the overall investment strategy.

APRA response

The investment management framework required by SPS 530 requires RSE licensees to manage and monitor all identified sources of investment risk. As such, APRA remains of the view that an RSE licensee must determine the range of investment risk factors it considers, the weighting given to each type of investment risk, the measures to assess the risk and the controls adopted to manage the identified risk.

APRA, however, recognises the increasing significance and materiality of ESG financial risk factors in the range of investment risks considered by a prudent RSE licensee, regardless of investment philosophy.

Reflecting that these risks are long term in nature and remain an emerging risk area for many RSE licensees, APRA intends to issue draft guidance on how a prudent RSE licensee can reflect ESG considerations in the investment strategy. This may include demonstrating, through scenario analysis and stress testing, the impact of investment decisions and risk management on the investment portfolio and the broader market.

CPG 229 recognises that climate risks are an evolving area for RSE licensees to assess and manage, noting that a prudent institution would take a strategic and risk-based approach to the management of climate risks and that the Board would be able to evidence ongoing oversight of these risks. APRA intends to clarify the linkages between SPG 530 and CPG 229 in the upcoming release of draft SPG 530, particularly with reference to stress testing, and that ESG financial risk considerations are expected to cover matters beyond climate change financial risk.

2. Valuation

Submissions generally supported the requirement for RSE licensees to have an adequate valuation governance framework as part of their broader investment governance framework but requested detailed guidance to support the implementation of the requirement.

Areas identified for guidance included when independent valuations would be considered appropriate, what valuation sources should be used and how results should be reported to the Board or relevant sub-committee to provide comfort on the robustness of the valuations and underlying methodology. Submissions also called for clarification on the expected frequency of regular valuations and when interim valuations should be undertaken.

APRA response

The findings of APRA's recent Unlisted Asset Valuation thematic review highlighted the need for considerable improvement in industry approaches to valuations and the need to conduct valuations proactively and regularly.³

Reflecting the nature and extent of the new requirements in SPS 530, APRA intends to update SPG 531 to outline APRA's expectations of a robust valuation governance framework.

APRA intends that draft SPG 531 will address:

- **valuation governance**, including the use of independent experts, segregation of investment decision makers and valuers, the development of a valuation methodology and the use of stand-alone board sub-committees and Board reporting;
- **valuation methodology**, including sources of valuations and their hierarchies, valuation approaches and methodologies, and the use of assumptions and estimates in valuations, independent assurances and triggers for interim valuations;
- **frequency and monitoring**, including how an appropriate frequency for valuing assets would be determined, with an expectation that this would generally be at least quarterly, and how the sequencing of valuations would be managed across different asset types; and
- **types of valuation risk**, including a comprehensive list of the types of valuation risk APRA expects prudent RSE licensees would consider.

3. Investment stress testing

Submissions noted that whilst stress testing is a key investment risk management tool, there are a range of additional quantitative risk management processes that provide different insights, such as sensitivity analysis, scenario analysis and 'Value at Risk', which prudent RSE licensees would consider.

In recognising that stress testing is one of the primary risk management tools used across the industry, other submissions called for more detailed guidance on how stress tests should be constructed. They requested that APRA provide details of example scenarios, with a focus on plausible scenarios and reasonable time periods for events that are to be considered.

Submissions also requested further guidance on how stress tests should be framed in terms of member outcomes and connected to performance test results. Views were expressed that APRA consider extending stress testing requirements beyond the investment option level to include consideration of fund, sub-fund and product levels.

Submissions indicated the need for APRA to provide additional guidance on APRA's expectations for RSE licenses to use independent experts in the construction and development of stress test scenarios. Questions were also raised on the extent to which APRA's expectations would differ for smaller, and potentially less resourced, entities where the costs of comprehensive stress testing may be considered prohibitive or to outweigh the benefits.

³ Refer to [Findings of APRA's superannuation thematic reviews](#).

APRA response

Stress testing is a key component of sound investment risk management. APRA has observed that whilst stress testing is used extensively across the industry, there is a significant need to improve practices to ensure that stress testing processes are improved, formalised and appropriately incorporated into the investment decision making process.

Periods of recent heightened volatility in investment markets have demonstrated the need for RSE licensees to develop comprehensive stress testing programs. This includes consideration of severe but plausible cash outflows, severe negative impacts to valuations and consequences for the investment portfolio and liquidity at the most granular possible/practical level. APRA considers an RSE licensee is best placed to construct scenarios relevant to the specific nature and circumstances of the RSE. APRA does not, therefore, intend to include specific scenarios in SPG 530, and will instead focus on guidance on the key considerations an RSE licensee would apply when constructing scenarios.

SPS 530 requires an RSE licensee to undertake the comprehensive investment stress-testing program at least annually, with results of the comprehensive stress-testing program being reviewed by the Board, relevant Board sub-committees and senior management. SPS 530 also requires the Board to document the methodology for stress scenario selection. It is likely that APRA expectations in relation to these matters will be reflected in draft SPG 530.

4. Liquidity management

Feedback from submissions on this area was relatively minimal, other than to provide general support for APRA's proposed amendments with respect to liquidity and cash flow management.

Submissions also suggested that APRA extend requirements beyond the investment option level to products and sub-funds.

APRA response

The requirements in SPS 530 relating to the liquidity management plan are designed to be minimum standards, so it is open to an RSE licensee to design their plan with reference to product, sub-fund or fund level considerations as appropriate.